

ECONOMIC STABILIZATION FUND

Texas Comptroller of Public Accounts — February 2020

Background

The Economic Stabilization Fund (ESF) — commonly called the “Rainy Day Fund” — was created by the passage of an amendment to the Texas Constitution in November 1988. The ESF is established in Article III, Section 49-g of the Constitution and became effective on Sept. 1, 1989.

Section 49-g spells out:

- Revenue sources deposited *to* the ESF and
- Requirements for making appropriations *from* the ESF

In November 2014, a constitutional amendment was passed allocating at least one-half of certain severance taxes to the ESF and the remainder to the State Highway Fund. Depending on the balance at the time of the transfer, more than half of the allocated severance taxes could be moved to the ESF in order to maintain the required sufficient balance under Section 316.029, Government Code.

The sufficient balance is set prior to each regular legislative session and was previously determined by a joint select legislative committee. Senate Bill 69, passed in May 2019, requires the Comptroller, beginning in fiscal 2022, to determine a sufficient balance equal to 7 percent of the certified general revenue-related appropriations made for that fiscal biennium.

In May 2015, the 84th Legislature passed House Bill 903 instructing the Comptroller to invest a percentage of the fund balance in a state fiscal biennium that exceeds the amount of the sufficient fund balance. Investments are made in accordance with Section 404.024(j), also known as the prudent investment standard. The Comptroller adjusts the investment portfolio periodically to ensure the balance is adequate to meet the cash flow requirements of the fund. Senate Bill 69 also requires at least one quarter of the ESF balance be invested in a manner that ensures liquidity and authorizes the Comptroller to pool ESF assets with other state assets for investment purposes.

How the ESF is funded

The ESF receives:

- An amount from General Revenue (GR) of at least one-half of 75 percent of Oil Production and Natural Gas Production tax revenues in any fiscal year that exceeds fiscal 1987 collections, exclusive of legislative action altering that amount, with the remainder going to the State Highway Fund. These taxes are also referred to collectively as “severance” taxes.
- One-half of any unencumbered GR surplus at the end of each biennium. Unencumbered GR is net of the amount of any tax allocations yet to be made, state agency encumbrances, accounts payable and payroll accruals, dedicated account balances and any required transfers to the ESF.
- All of the interest earned on the ESF balance.
- Direct appropriations to the ESF by the Legislature. Through fiscal 2019, no direct appropriations to the ESF have been made.
- The Comptroller’s office has up to 90 days after the end of the fiscal year to make transfers to the ESF — transfers are typically performed in late November.

KEY FACTS

- ❖ Fiscal 1987 collections thresholds:
 - Natural gas production = \$599.8M
 - Oil production = \$531.9M
- ❖ Result of passed November 2014 constitutional amendment:
 - One-half of 75% of Oil and Natural Gas Production tax revenues transfer to ESF; remainder to State Highway Fund contingent on legislative actions
- ❖ Fiscal 2018 Oil and Natural Gas Production tax revenues triggered a \$2.8B transfer in November 2018, \$1.4B to ESF and \$1.4B to State Highway Fund
 - Ending fiscal 2019 ESF cash balance was \$6.8B with \$3.3B in investments for a total balance of \$10.1B
- ❖ Fiscal 2019 Oil and Natural Gas Production tax revenues triggered a \$3.3B transfer in November 2019, \$1.7B to ESF and \$1.7B to State Highway Fund
- ❖ The ESF cap for the 2020-21 biennium is \$18.8B
- ❖ The ESF sufficient balance for the 2020–21 biennium is \$7.5B
- ❖ The ESF balance is expected to remain below the cap through the end of the 2020–21 biennium

STATUTORY REFERENCE

Texas Constitution,
Article III, Section 49-g



The ESF Cap

The Constitution caps the *maximum* biennial ESF balance at an amount not to exceed 10 percent of certain GR deposited during the previous biennium. *Certain* GR is defined as the total amount deposited in the General Revenue Fund during the previous biennium *excluding* these revenue sources:

- Investment income
- Interest income
- Amounts borrowed from special funds

Reaching the ESF Cap

If the ESF were to reach the cap, the Texas Comptroller of Public Accounts (Comptroller's office) would:

- Reduce or eliminate transfers to the ESF to prevent the balance from exceeding the cap and
- Credit interest earned on the ESF balance to the General Revenue Fund

Transfers to and retention of interest in the ESF would resume in the first biennium in which the cap exceeds the ESF balance as a result of:

- An increase in the cap amount and/or
- A decrease in the ESF balance resulting from an appropriation

Calculating the ESF Cap

The ESF cap for each biennium is based on certain revenue collections in the *previous* biennium. For example, the ESF cap for the 2020–21 biennium is based on revenue collections in fiscal 2018 and 2019.

As provided by the Constitution, the Comptroller's office calculates the ESF cap for each biennium by:

1. Starting with total net revenue deposited to the General Revenue (GR) Fund 0001. This number is taken from the first column in Table 1: Statement of Cash Position in the [State of Texas Annual Cash Report](#) for each fiscal year of the previous biennium. **Note:** The table below breaks out the federal revenue from this number for informational purposes.
2. Deducting interest and investment income deposited to the GR Fund. This number is taken from the first column in Table 1: Statement of Cash Position in the *State of Texas Annual Cash Report* for each fiscal year of the previous biennium.
3. Adding revenue deposited to the GR Account — Tobacco Settlement 5040, excluding accounting transfers. This number is taken from the Fund Detail section of the *State of Texas Annual Cash Report* for each fiscal year of the previous biennium.
4. Adding the results for the two years together to produce the revenue base for calculating the ESF cap. Ten percent of the revenue base is the ESF maximum limit for the following biennium.

EXAMPLE: CALCULATION OF THE ESF CAP FOR THE 2020–21 BIENNIUM

	Fiscal 2018	Fiscal 2019	Biennium
General Revenue Fund			
Total Net Revenue Excluding Federal Funds	\$ 64,433,942,046	\$ 67,550,902,371	\$ 131,984,844,417
Plus: Federal Revenue	\$ 26,678,678,484	\$ 28,504,440,908	\$ 55,183,119,392
Less: Interest and Investment Income	\$ 29,294	\$ 126,248,529	\$ 126,277,823
Adjusted Net Revenue	\$ 91,112,591,236	\$ 95,929,094,750	\$ 187,041,685,986
Plus: GR Account 5040 (Tobacco Settlement)	\$ 448,243,541	\$ 489,872,318	\$ 938,115,859
Revenue Base	\$ 91,560,834,777	\$ 96,418,967,068	\$ 187,979,801,845
Constitutional Limit			10%
			\$ 18,797,980,185
Economic Stabilization Cap for 2020–21 Biennium			



History of ESF Caps and Balances

The graph in Figure 1 compares each biennial ESF cap to the maximum balance during that biennium.

It also illustrates that from the fund's beginning in the 1990-91 biennium through the 2018-19 biennium, both the ESF cap and maximum balance generally increased.

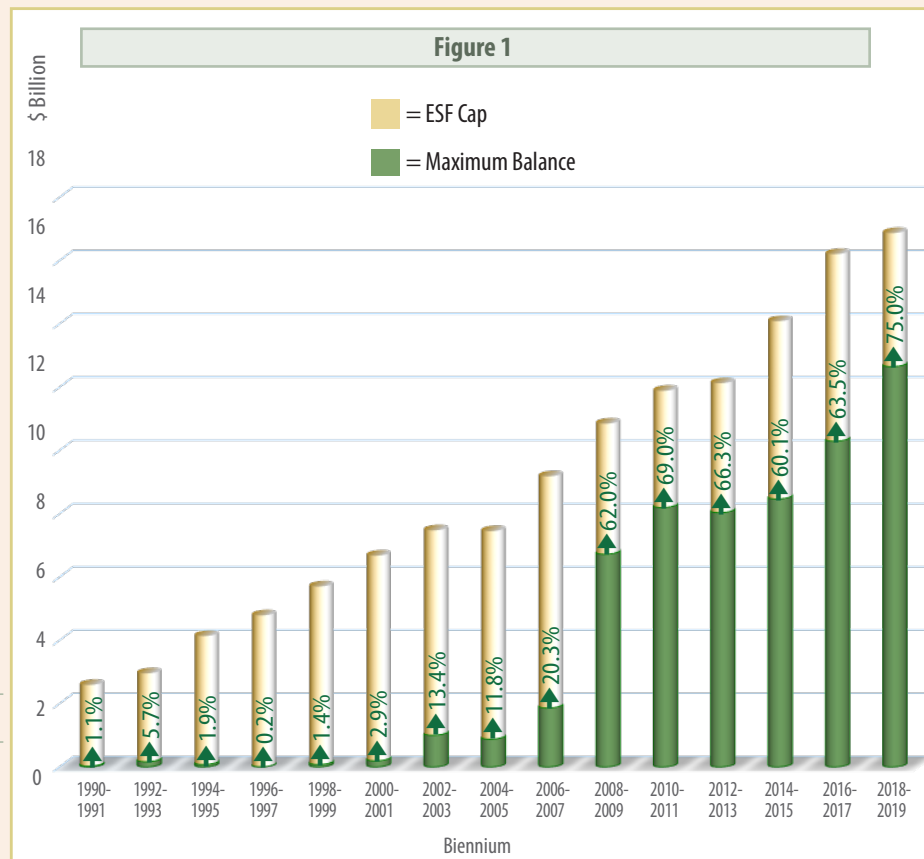
Each biennium's maximum balance is depicted as a percentage of the ESF cap. For the 2018-19 biennium, the maximum balance was 75 percent of the cap.

For more information, see [ESF History Table](#) that provides comprehensive data for the ESF cap calculations and includes the maximum and ending balances and percentages.

ESF History — by the Numbers

See the [ESF History Table](#) for a comprehensive history of:

- ESF revenues (transfers in)
- Appropriations (transfers out)
- Fiscal year-end balances
- Annual maximum balances
- Biennial caps
- Maximum balance as a percentage of the ESF cap
- Ending balance as a percentage of the ESF cap



ESF Impact on Credit Ratings

Credit rating agencies have methodologies to evaluate state credit that consider both quantitative and qualitative factors:

- States are generally seen as strong credits due to their considerable flexibility regarding taxing authority, revenue, spending and debt financing decisions.
- Primary areas of evaluation include: the economy, management, finances, budgetary performance and long-term liability/debt. The ESF funds generally represent a subcategory of one of those areas.
- The rating agencies focus on the overall health and strength of a state and consider the ESF, in context, as one of many tools available to address recession or unanticipated revenue or expenditure volatility.
- The rating agencies evaluate the constitutional or statutory structure of the ESF and consider historical practices regarding uses, balances and restoration of balances, if drawn upon.
- An ESF balance provides a flexible alternative, in addition to budgetary and revenue tools, to manage through challenging economic cycles. An ESF balance demonstrates fiscal strength and flexibility, but balances are not the only factor rating agencies consider.

